COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts	D.T.E. 01-20 Part A (UNE Rates)

AT&T'S OPPOSITION TO VERIZON'S MOTION TO REOPEN THE RECORD
AND
AT&T'S CROSS-MOTION TO STRIKE THE NEW EVIDENCE SUBMITTED BY VERIZON WITHOUT AUTHORIZATION

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Introduction

AT&T Communications of New England, Inc. ("AT&T") respectfully urges the Department to deny Verizon's motion to reopen the record in this proceeding. Verizon seeks leave to submit additional evidence in support of a claim that its new rates for unbundled network elements ("UNEs") constitute an unlawful taking of its property without just compensation. Verizon makes two assertions. First, it asserts that its new UNE rates are confiscatory because they fall below Verizon's average historic cost for providing UNE-L or UNE-P. Second, Verizon asserts that as a consequence its overall return on historic investment will fall below 3.3 percent, and that this also is confiscatory. *See* Verizon's Motion to Reopen at 4-5. Verizon appears to claim that the Department should at least double the current UNE rates, purportedly to protect its return on investment. *Id.* at 5, 7.

As we will demonstrate below, Verizon's motion is both procedurally and substantively without merit and should be denied.

First, the relief that Verizon is seeking violates both federal and state law, and therefore must be denied. The Telecommunications Act of 1996 expressly requires that UNE rates be set on the basis of forward looking costs without regard to rate of return, and orders of the Federal Communications Commission (the "FCC"), affirmed by the Supreme Court of the United States, have established total element long run incremental cost ("TELRIC") as the appropriate forward looking cost methodology for setting UNE rates. If Verizon wishes to challenge the constitutionality of the Telecommunications Act, its appropriate recourse (provided it has exhausted its other administrative remedies) is to the courts. However, in asking the Department to reopen this proceeding, abandon the TELRIC methodology, and increase UNE rates to reflect and recover Verizon's historic costs, Verizon seeks relief that is unlawful on its face.

Second, it is well established, as a matter of both state and federal law, that requiring a public utility to provide certain services at rates below some measure of cost does not constitute a taking of property, so long as it can earn an acceptable return on its overall business. Indeed, the setting of some rates below even long run incremental costs, never mind fully distributed historic costs, has a very long and well accepted history. This principle has been the guidepost for universal service policy over many years. Even if Verizon could prove that its UNE rates are set below historic costs, its confiscation claim would remain unfounded.

Third, as the Department has recently had occasion to reiterate, Verizon's claim that its return on its investment is unreasonably low cannot be heard in the context of any proceeding that addresses only a single set of rates to a single class of customers. *See* D.T.E. 01-31-Phase II, at 68-72 (2003). As the Massachusetts Supreme Judicial Court and the United States Supreme Court have found, a claim that rates are confiscatory cannot be considered except through an analysis of the "total effect" and "end result" of the "overall rates" of a regulated carrier.

Thus, in order to determine whether Verizon can legitimately show that its overall rate of return is too low, the Department would have to undertake a full-blown cost of service and rate of return study, investigating all of Verizon's costs and rates. While the United States Supreme Court left open the possibility that Verizon could pursue a confiscation claim once TELRIC rates were established, it did not invite Verizon to use shortcut or inappropriate methods to support such claims. Verizon's request to focus on UNE rates in this case amounts to a single-issue rate case, long rejected by the Department because it allows the utility to cherry-pick for adjustment the rates that are "too low" while keeping off the table the rates that are "too high." *Cf., e.g., New England Telephone and Telegraph Company*, D.P.U. 84-267 (1985); *Cambridge Electric Light Company*, D.P.U. 490 (1981).

In addition, Verizon's motion to reopen this docket and its slip-shod proposed cost support are entirely inconsistent with the evidence reviewed and the findings issued unanimously by the Department in DTE 01-31. Indeed, while couched as a challenge to rates for unbundled network elements ("UNEs"), Verizon's confiscation claim is in fact a collateral attack on the Department's decisions in Docket 01-31. With respect to residential service, Verizon asserts that the average historic costs of providing UNE-P on a wholesale basis exceed $40 per line per month. *See* Verizon's Motion to Reopen, at 5. Verizon represents that this figure excludes avoidable retail costs of $11.03 per month. *See* Proposed Testimony of West and Prosini, Attachment A, Page 2 (Tab "Cost – Avoidable"). Thus, according to Verizon's own proposed evidence its total monthly cost to provide the same services on a retail basis are approximately $52 per month. In other words, if one were to believe the new evidence proposed by Verizon, its historic cost of providing residential service is more than twice the new monthly retail rates established by the Department in Phase II of Docket 01-31.[1]

Given this evidence, if Verizon has a claim that its rate of return is too low, it cannot blame that fact on UNEs. Verizon's *retail* revenue streams have a far greater impact upon Verizon's rate of return. Using Verizon's own proposed evidence, its average revenue shortfall for retail services (the difference between retail revenues and historic costs as Verizon calculates them) is greater for lines served on a retail basis than for lines served on a UNE basis. And, of course, Verizon has far more retail lines on which to suffer these revenue shortfalls than it does wholesale lines served by UNEs. After all, the new UNE-P rates only just became effective and

[1] Furthermore, in Phase I of Docket 01-31 the Department found that many of Verizon's retail services for business customers are contestable by competitive carriers through UNEs, and on that basis granted upward pricing flexibility to Verizon for those services. D.T.E. 01-31-Phase I, at 92 (2002). Verizon's request that the Department now double UNE rates would eviscerate the basis for this decision, and require renewal of price cap or perhaps even rate-of-return regulation for Verizon.

UNE competition based on the previous rates was severely limited. Hence, if Verizon's current overall rate of return is unlawfully low – which is what Verizon claims – that fact has not been caused by the Department's UNE rate decision or the presence of UNE-P in the market. The principal contributing factor, using Verizon's own logic and mathematics, would be its retail rates. More fundamentally, it is precisely because this form of analysis is not valid that the Department, the FCC,[2] and the courts have held that a confiscation claim cannot heard except in the context of a review of all services, their costs and revenues.

Verizon is not without a remedy if it believes that its current rates are insufficient to support the economic health of the firm, but that remedy does not lie in asking the Department to set UNE rates above TELRIC levels. Rather, if Verizon wishes to pursue a complaint that its overall return is too low, Verizon's remedy is to file a rate of return case asking the Department to revisit all of the conclusions it just reached in Docket 01-31.

In short, the Department's UNE rate findings should not be revisited, as they are fully consistent with federal law, FCC requirements, and the Department's long-standing goal of fostering local competition. If however, the Department grants the motion to re-open this docket in order to investigate Verizon's fundamentally flawed confiscation claim, AT&T respectfully submits that the investigation would be have to very broad, as it would require an analysis of the

[2] As the FCC noted in its recent Triennial Review order, "Insofar as unbundling in such areas brings about pressure for reductions in 'above cost' rates, it should not be a matter for regulatory concern unless an incumbent LEC's overall earnings for telecommunications services fall below confiscatory levels." *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No 01-338, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, and *Deployment of Wirline Services Offering Advanced Telecommunications Capacity*, CC Docket No. 98-147, "Report and Order and Order on Remand and Further Notice of Proposed Rulemaking," No. FCC 03-36 (released August 21, 2003) ("the FCC's Triennial Review Order"), ¶ 167.

"total effect" and "end result" of all of Verizon's costs, rates, and revenues. In short, it would require a comprehensive rate of return review.

Argument

I. VERIZON'S MOTION FAILS TO MEET THE STANDARDS FOR REOPENING THE RECORD.

To prevail on its motion to reopen the record in this proceeding, Verizon must prove both that the new evidence it proposes to offer "would be likely to have a significant impact on the decision," and that it was unable to submit its newly proffered evidence at any earlier time. Verizon's Motion to Reopen at 2, quoting *Bay State Gas Co.*, D.T.E. 01-81, at 20-21 (2002).

> The Department's procedural rule on reopening hearings, 220 C.M.R. § 1.11(8), states, in pertinent part, "[n]o person may present additional evidence after having rested nor may any hearing be reopened after having been closed, except upon motion and showing of good cause." Good cause for purposes of reopening has been defined as a showing that the proponent has previously unknown or undisclosed information regarding a material issue that would be likely to have a significant impact on the decision already rendered.

Massachusetts-American Water Company, D.P.U. 95-118-A, at 2 (1996). Verizon cannot satisfy either prong of the two-part test.

For the reasons discussed below, Verizon's proposed new evidence would be inadequate to make out a takings claim even if it were true, and fails to provide any lawful ground upon which the Department could increase the UNE rates that it just set. Since Verizon's allegations would not justify a finding that its rates are confiscatory, its takings claim need not and should not be considered on the merits. *See Baltimore & O.R. Co.* v. *United States*, 345 U.S. 146, 147, 73 S.Ct. 592, 593 (1953) (affirming on this ground dismissal of a claim that regulated rates were confiscatory). The additional evidence proposed by Verizon would be insufficient to support any change in the Department's prior findings in this case, and therefore Verizon has failed to satisfy the Department's standard for reopening the record to consider new evidence. *Petition of New*

England Telephone for an Alternative Regulatory Plan, D.P.U. 94-50 at 52 (1995); *see also, e.g.*, *New England Telephone*, D.P.U. 96-68, at 10 (1997).

A. Verizon May Not Ask the Department to Set UNE Rates Far Above TELRIC-Compliant Levels.

It would be unlawful for the Department to grant the specific relief sought by Verizon. Verizon urges the Department to reopen the record in order to consider "whether and how to modify the final [UNE] rates." Verizon's Motion to Reopen, at 1-2. It wants the Department at least to double its new UNE rates, on the ground that such an increase is purportedly required to permit Verizon to recover its "historical investment and actual out-of-pocket operating expenses." *Id.* at 5, 7. In sum, Verizon is asking the Department to violate its statutory obligation to set UNE rates that comply with Telecommunications Act and the FCC's TELRIC methodology.

State commissions may not ignore the law. They must set UNE rates in accord with the FCC's TELRIC methodology, and may not set UNE rates on any other basis. *AT&T Corp.* v. *Iowa Utilities Board*, 525 U.S. 366, 384-385, 119 S.Ct. 721, 732-733 (1999). "Congress directed the FCC to prescribe methods for state commissions to use in setting rates." *Verizon Communications, Inc.* v. *FCC*, 535 U.S. 467, 476, 122 S.Ct. 1646, 1654 (2002) (citing 47 U.S.C. § 252(d)). The FCC has done so, and the Supreme Court has upheld its adoption of the TELRIC methodology. *Id.*

Neither the Telecommunications Act nor the FCC's TELRIC regulations permit taking rate of return considerations into account in setting UNE rates. The Department may not entertain Verizon's request for a substantial increase in UNE rates – and UNE rates alone – in order to permit Verizon to earn a higher overall return on its total historic investment. *See* Verizon's Motion to Reopen, at 2, 5-7. Congress has specifically barred the setting of UNE rates by "reference to a rate-of-return or other rate-based proceeding." 47 U.S.C. § 252(d)(1)(A).

Thus, state commissions are required by law "to set the rates charged by the incumbents for leased elements on a forward-looking basis untied to the incumbents' investment." *Verizon Communications*, 535 U.S. at 475, 122 S.Ct. at 1654. This does not mean that the Department cannot consider the adequacy of Verizon's return on investment: it means only that it cannot undertake an investigation into that adequacy as a basis for setting UNE rates. If Verizon wants to argue that its overall return is insufficient, it should petition the Department to open a full-blown cost-of-service rate case to investigate all of Verizon's costs and sources of revenue. The Department is precluded, however, from setting UNE rates on some basis other than TELRIC.

B. Verizon Has No Takings Claim Because Its Proposed Evidence Does Not Show that the "Total Effect" of Its "Overall Rates" Is to Deny Verizon the Ability to Earn an Economic Return on Its Network.

1. Verizon's Claim that UNE Rates Are Below Historic Costs Is Not Relevant, and Cannot Form the Basis of a Takings Claim.

If the Department were to reopen the proceeding, Verizon would have the burden of proving that its rates are so low that they result in the unlawful confiscation of its property. *Massachusetts Elec. Co.* v. *Department of Public Utilities*, 376 Mass. 294, 299 (1978). To satisfy this burden, Verizon would have to show that its "overall rates" do not permit it to earn a fair return. *Automobile Insurers Bureau of Massachusetts* v. *Comm'r of Insurance*, 420 Mass. 599, 612-613 (1995). If the "total effect" is not unreasonable, then "judicial inquiry … is at an end." *Automobile Insurers*, 420 Mass. at 613, quoting *Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 310 (1989), and *Federal Power Comm'n* v. *Hope Natural Gas*, 320 U.S. 591, 602 (1944). It is the "end result" that matters. *Boston Edison Co.* v. *Department of Public Utils.*, 375 Mass. 1, 19 (1978). Purported errors in calculating some portion of Verizon's rates are, therefore, irrelevant. "[A]ll that matters are the actual, over-all rates." *Automobile Insurers*, 420 Mass. at 612. Verizon would also have to demonstrate that "any deficiency in [its] returns is solely the result of the rate-setting and not of other factors." *Id.*, 420 Mass. at 613; *accord Trust Ins. Co.* v.

Comm'r of Insurance, 425 Mass. 1001 (1997). As explained below, Verizon's proposed evidence is incapable of meeting these legal standards for a takings claim.

Verizon alleges that its average monthly cost of providing UNE-P is just over $40 while its revenues are only $18.69, and that its average monthly cost of providing UNE-L is roughly $25 while its revenues are only $13.93. *See* Verizon's Motion to Reopen, at 5. Even if entirely accurate, this comparison of revenues to embedded costs for only two of the many services that Verizon provides over its network would fail to state a viable takings claim.

It is well established that a public utility may be required to provide certain services at non-compensatory rates, so long as it is able to make money on its over-all business. *Baltimore & O.R. Co.*, 345 U.S. at 147-150, 73 S.Ct. at 593-594. Where the property being used to provide public service returns a profit, the utility cannot make out a claim that its property was taken without just compensation. *Id. Accord, e.g., Pan American World Airways* v. *Civil Aeronautics Board*, 256 F.2d 711, 712 (D.C. Cir. 1958) ("A carrier may be required to charge for a particular service a rate that is not fully compensatory, in the sense that it does not cover fully allocated costs and return."); *Brooklyn Eastern District Terminal* v. *United States*, 302 F.Supp. 1095, 1100 (E.D.N.Y. 1969) ("Compulsion to continue a service rendered at a loss is not necessarily an unconstitutional taking of property, since there is no general principle that every component of an integral whole of utility service must show a profit."); *Northwestern Pacific R.R. Co.* v. *United States*, 228 F.Supp. 690 (N.D. Cal. 1964) (no confiscation results from an order that a utility provide an unprofitable service, unless it is shown that this results in "a net loss to the entire system" or network operated by the utility); *Southern Pac. Co.* v. *Public Utilities Comm'n*, 41 Cal.2d 354, 260 P.2d 70, 1 P.U.R.3d 438 (Cal. 1953, *en banc*) ("Where the overall operations of [a utility's] intrastate service is profitable … the commission may compel the continuation of

a portion of such services at a financial loss and such a requirement raises no issue under the Federal Constitution.").

> [I]t frequently happens that, when general revenues and expenses are computed on an overall basis, applicable to the entire business of a carrier, some items, if separated, appear as carried at non-compensatory rates. This result ensues from the compelling obligation of the carrier to render public service, and it has been approved.

Guam v. Federal Maritime Comm'n, 329 F.2d 251, 254 (D.C. Cir. 1964).

Verizon errs by relying on seemingly contrary dicta found in *Brooks-Scanlon Co.* v. *Railroad Comm'n*, 251 U.S. 396, 399, 40 S.Ct. 183 (1920). *See* Verizon's Motion to Reopen, at 8 fn.19. *Brooks-Scanlon* actually stands only for the proposition that a utility cannot be required to run its entire intrastate operations at a loss; it is in no way inconsistent with the proposition that a utility which makes an over-all profit may be required to provide particular services at a loss. *See, e.g., Alabama Public Service Comm'n* v. *Southern Railway*, 341 U.S. 341, 347, 71 S.Ct. 762 (1951); *In the Matter of Erie Lackawanna Railway Co.*, 517 F.2d 893, 898 (6th Cir. 1975).[3] The *Baltimore & O.R. Co.* case, decided 33 years after *Brooks-Scanlon*, states the correct rule of law. The correct rule is fatal to Verizon's takings claim.

Verizon quotes a recent Supreme Judicial Court decision, in the *Town of Hingham* case, for the proposition that a utility's rates must provide it with the opportunity to earn a fair return. *See* Verizon's Motion to Reopen, at 6. But Verizon quotes only a portion of the relevant sentence. The complete quote is as follows: "[r]ates for service provided by a regulated public utility must allow a fair rate of return to investors on the value of the ***property used in providing those services***." *Town of Hingham* v. *Department of Telecommunications & Energy*, 433 Mass.

[3] A subsequent three-judge panel of the Sixth Circuit made the same error as Verizon regarding *Brooks-Scanlon* in its one-sentence treatment of this issue. *See Michigan Bell Tel. Co.* v. *Engler*, 257 F.3d 587, 593 (6th Cir. 2001) Verizon's reliance on this passing reference is therefore also misplaced.

198, 205 (2001) (emphasis added). As Verizon acknowledges, the physical network that is used to provide wholesale services priced as UNEs is the same property used to provide the entire panoply of Verizon's retail and wholesale services in Massachusetts. Similarly, Verizon has one set of investors. It does not offer separate stock for those who wish to invest only in its wholesale UNE business. Since Verizon's historic investment was in a network used to provide a multiplicity of retail and wholesale services, it receives constitutionally adequate compensation so long as its rates in the aggregate produce a sufficient total return.

A public utility's claim of unconstitutional confiscation in rate making "must be proved with reference to the utility's entire rate base, defined as the value of a utility's property used and useful in providing its service, and not with regard to only a portion of its total investment." *Lake of the Woods Utility Co.* v. *State Corporation Comm'n*, 223 Va. 100, 108, 286 S.E.2d 201, 205 (1982) (citations omitted). Thus, "proof of a utility's claim of confiscation must be based on an examination" of "aggregate revenues, aggregate costs, appropriate adjustments, and a fair return on the utility's total rate base." *Id.*, 223 Va. at 109, 286 S.E.2d at 206. Where, as here, a utility claims that only some portion of its total rates have been set below cost, the utility has failed to state an actionable takings claim. *Id.*

This means that Verizon's constitutional takings claim is not even ripe until Verizon has exhausted attempts to have the Department to consider all of its rates in a rate case. *See generally Williamson County Regional Planning Commission* v. *Hamilton Bank of Johnson City*, 473 U.S. 172, 186, 194-195, 105 S.Ct. 3108 (1985) (takings claim is not ripe until claimant has exhausted all procedures for obtaining just compensation). The mere fact that UNE rates have been set is not enough to trigger a takings claim. Such a claim would not be ripe unless and until Verizon fully pursued an increase in its retail rates sufficient to cure any claim that its total return

from its overall rates is somehow inadequate. *US West Communications, Inc., v. Minnesota Public Utilities Commission,* 55 F.Supp.2d 968, 990 (D.Minn. 1999).

Verizon champions a novel theory that a takings analysis should ignore revenues from competitive lines of business, even if they provide a portion of the return on the total property that is also used to offer wholesale services as UNEs. *See* Verizon's Motion to Reopen, at 7-8. This approach would lead to perverse results. If Verizon were eventually granted upward pricing flexibility for all retail rates, under Verizon's theory a takings analysis would have to ignore all retail revenues, and its UNE rates would be confiscatory unless they alone produced revenues adequate to recover Verizon's entire rate base. Verizon's reasoning seems motivated by Verizon's wish to push UNE rates to stratospheric levels while reducing retail rates to low levels that will not support any facilities-based competition. The Department has recently rejected precisely such an approach, however, and cautioned that conducting a cost-of-service analysis "for only one set of Verizon customers" would have the very real danger of facilitating the ability of Verizon "to cross-subsidize competitive services with revenues from regulated services." D.T.E. 01-31-Phase I, at 99 (2002); D.T.E. 01-31-Phase II, at 70 (2003). It would make no more sense for the Department to conduct a cost-of-service analysis for a narrow set of Verizon's services under the guise of a takings claim, than it would as a means to establish rates in the first instance.

Verizon's insistence on proposing evidence that looks solely at its purported margin on selling UNEs only, while ignoring the many other revenue sources that Verizon uses to cover the costs of its network and operations, cannot be squared with many decades of regulatory practice in the telecommunications industry. For literally decades, telecommunications carriers were required to provide some lines of service at rates below historic costs and sometimes even incremental costs, with the understanding that each carrier would be made whole overall through

higher profits earned on other lines of business. "Long-distance, toll, and business rates were priced above cost in order to subsidize basic residential services, which were priced below cost to promote universal service." D.T.E. 01-31-Phase II, at 69 (2003), citing D.P.U. 93-125, at 4 (1994). New England Telephone did not bring takings claims on the theory that it was required to operate one line of its business at a loss, because it knew that such claims would have no basis in law. Much the same kind of tradeoffs motivated the drafting of the Telecommunications Act of 1996: RBOCs like Verizon agreed to provide UNEs at forward-looking cost, and thereby suffer a decrease in their revenues from intrastate services, in exchange for being permitted in time to enter the interexchange market for long distance services and garner added revenues on that front. Having achieved the benefits (and the revenues) of the bargain it struck in supporting the Telecommunications Act, Verizon now seeks to renege on its obligation to provide UNEs at forward looking cost-based rates, on the grounds that its revenues solely from UNEs (ignoring the offsetting benefits achieved by offering long distance services) purportedly do not recover its historic costs. It remains true that there is no basis under law for Verizon to bring a takings claim on the theory that it wants to make more money than the Department has allowed on a single line of business, in this case its wholesale UNE business.

In sum, Verizon's assertion that its average cost of providing UNE-L or UNE-P exceeds its per unit revenues is simply irrelevant. Even if true, it could not serve as the basis for any finding that Verizon's overall return, for its entire network, is so low as to result in the regulatory confiscation of its property without just compensation.

2. Though Verizon Claims that Its Total Return Is Too Low, Its Own Proposed Evidence Shows that the New UNE Rates Are Not to Blame.

Verizon also argues that its total return on historic investment is too low. But its proposed evidence makes clear that this situation, even if accurately depicted, was not brought about by the Department's newly established UNE rates. Because Verizon cannot show that any

deficiency in its overall return on investment is due to the new UNE rates, its proposed takings challenge to those UNE rates could not succeed. *See Trust Ins. Co.*, 425 Mass. 1001; *Automobile Insurers*, 420 Mass. at 613.

Verizon asserts that the retroactive application of its new UNE rates back to August 2002 will reduce its total return on its Massachusetts operations for 2002 to roughly 3.29 percent.[4] Curiously, but not surprisingly, Verizon does not bother to mention what its return would be without this change. We can see from Verizon's proposed new cost model, however, that if Verizon's 2002 return is calculated in the same way assuming that its UNE rates had remained unchanged, the result would be still be a return of only 3.88 percent.[5]

In short, if Verizon has a rate of return problem, UNEs are not causing it. This is because UNEs represent a very small portion of all the revenue-producing services that Verizon provides over its local network. Based on Verizon's own figures, no more than five percent of its network capacity was sold as UNEs in 2002.[6]

Moreover, if Verizon's calculations of its return on investment were at all accurate, they would merely show that Verizon's existing retail rates – which comprise the vast majority of Verizon's total revenues – are inadequate. But Verizon 's retail rates are either set by the Department outside this UNE rate proceeding or are already freed to be set by market forces subject to Departmental oversight. The Department has given Verizon upward pricing flexibility

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[4] *See* Verizon's Motion to Reopen at 5; Proposed Testimony of West and Prosini, at 4, 22, and Attachment A, Page 3 (Tab "43-01").

[5] *See* Proposed Testimony of West and Prosini, Attachment A, Page 3 (Tab "43-01"). If the Rate of Return on Line 12 is calculated in the same manner for column "A" as Verizon did for column "B", the result is an unadjusted return of 3.88 percent.

[6] Verizon calculates that it had 4,239,936 loops in service in 2002. Proposed Testimony of West and Prosini, Attachment A, Page 8 (Tab "Inputs"). It also reports that a total of 210,521 of those loops were purchases in either a UNE-L or a UNE-P arrangement. *See* Proposed Testimony of West and

for most of its retail offerings to business customers, to the extent that Verizon's retail business services "are contestable on a UNE basis." D.T.E. 01-31-Phase I, at 92 (2002). If low rates for those services are keeping Verizon's return down, Verizon has only its own pricing decisions, marketing failures, or inability to compete to blame. Only a full investigation of all Verizon services would make it possible to determine which factors have come into play. In addition, Verizon just increased its basic residential rates by approximately $2.00 per month per customer. D.T.E. 01-31-Phase II (2003). Verizon fails to take into account these new revenue streams and revenue opportunities in the analysis it wishes to present in its proposed evidence. This represents a complete failure of proposed proof, and is yet another reason why the proposed evidence could not serve as the basis for further action by the Department. *See, e.g.*, *Massachusetts-American Water Co.*, D.P.U. 95-118, at 175-176 (1996).

It is also important to note that Verizon's proposed evidence, if assumed to be true, would also show that its residential services are priced far below their historic cost and are, therefore, a far greater drain on the financial viability of the firm than are UNEs. Verizon's basic residential service, its so-called One Party Measured Residential Service or "1MR", is now priced at $18.30 per month.[7] Verizon's most popular bundled residential service package, its One Party Unlimited Local Residential Service or "1FR", is now priced at $25.24.[8] Verizon claims, for the first time in its motion to reopen this proceeding, that its monthly recurring cost of

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Prosini, Attachment A, Page 14 (Tab "UNE Forecast"). Verizon states that in 2002 it provided 139,222 UNE-L arrangements, plus 71,299 UNE-P arrangements, for a total of 210,521 loops provide as UNEs.

[7] In Docket 01-31, the Department directed Verizon to increase its residential dial-tone line rate by $2.44, which was partially offset by the elimination of the previously separate charge of $0.49 for dial tone service. The total of this $1.95 increase per month, plus the previous basic rate of $9.91, plus the new subscriber line charge ("SLC") for Massachusetts of $6.44, produces a total rate of $18.30. *Cf.* D.T.E. 01-31-Phase II, at 68 & 79, fns. 56 & 58 (2003).

[8] The previous charge of $16.85 per month for 1FR service, plus the net rate increase of $1.95, plus the $6.44, produces a total rate of $25.24. D.T.E. 01-31-Phase II, at 82 (2003).

providing these services at retail is over $52 per month, including a claimed wholesale cost of $41 per month plus an avoidable retail cost of $11.03 per month.[9] Thus, Verizon's own evidence would demonstrate that Verizon suffers a far greater revenue loss per line from its retail services (losses of $33.70 per line at the 1MR rate and $26.76 at the 1FR rate) than it does for its wholesale services ($11.31) based on UNEs. To repeat: this is what Verizon's own data shows.

In sum, if Verizon truly believed that its basic residential rates were capped at less than half the cost of providing service, then it should have challenged the Department's Phase II order in Docket 01-31. The fact that it did not do so is powerful evidence that Verizon does not really believe that its return on investment in Massachusetts is inadequate. Verizon's attempt to obtain increases in rates charged to its competitors and not to its retail customers suggests another motive. Verizon may not acquiesce in retail rates below historic cost and then demand that its wholesale rates be raised to recover the alleged revenue shortfall.

Indeed, the Department rejected precisely this form or argument in its recent Phase II decision in Docket 01-31. There, the Department found that "conducting an embedded cost-of-service study today for only one set of Verizon customers would be difficult and, more importantly, would not produce an economically rational result." D.T.E. 01-31-Phase II, at 70 (2003). This is because the allocation of shared costs "would be unacceptably arbitrary." *Id.* As the Department found, a cost-of-service, rate-of-return analysis only makes sense in the aggregate, looking at Verizon's total recorded costs in a test year and determining whether revenues in the aggregate would be sufficient to prove a fair return on the total rate base. *See* D.T.E. 01-31-Phase II, at 69 (2003).

[9] Proposed Testimony of West and Prosini, Attachment A, Page 2 (Tab "Cost – Avoidable").

The analysis does not differ here. If Verizon really has a rate of return problem, its remedy is not in reopening a case that addresses only one set of rates. Its remedy is a rate case, to investigate all of Verizon's costs and revisit all of its retail rates.

C. In Any Case, There Is No Merit to Verizon's Assertion that It Could Not Have Introduced This Kind of Evidence Earlier in the Case.

To succeed on its motion to reopen the record, Verizon must also prove that it would have been impossible to present its proposed new evidence before the Department made its final decision regarding the proper level for UNE rates. *See* Verizon's Motion to Reopen, at 2.

Verizon knew, from the very beginning of the case, that rates would be set on the basis of forward looking costs as measured by the TELRIC methodology. It knew that its historic costs would not be taken into account. It also knew what its historic costs are. Indeed, it is absurd for Verizon to argue that is own ARMIS data was unknown or not disclosed to it prior to the close of the evidentiary record in this case. This alone warrants denial of Verizon's motion to reopen. *See, e.g.*, *Blackstone Gas Co.*, D.T.E. 01-50 at 14-15 (2001).

While Verizon may not have known the specific rates that would come out of the UNE rate decision, it knew with certainty that those rates would not recover its costs measured on a fully distributed historic cost basis, at least according to the methodology followed in Verizon's proposed evidence. Indeed, Verizon's own proposed UNE rates offered in this proceeding would have produced a total UNE-P charge of approximately $29 per month, based on the same usage assumptions employed by Verizon to estimate monthly UNE-P costs based on the final rates approved by the Department. If Verizon truly believes that on average it costs Verizon about $40 per month to provide a UNE-P arrangement, then even the rates proposed by Verizon itself would have been confiscatory under Verizon's reasoning. If these arguments had any merit, which they do not, Verizon could, and hence should, have raised them and proffered supporting evidence at any time during this proceeding.

II. THE ONLY WAY FOR THE DEPARTMENT TO ADDRESS ANY LEGITIMATE CLAIM THAT VERIZON'S OVERALL RETURN IS TOO LOW WOULD BE TO OPEN A NEW, FULL BLOWN RATE-OF-RETURN AND COST-OF-SERVICE INVESTIGATION.

Verizon's motion to reopen the record is based in part on its claim that its overall rate-of-return on historic, embedded investment is inadequate. Verizon asserts that if it "were compelled to continue providing UNEs to CLECs at the rates set by the Department, it would be unable to earn a constitutionally sufficient rate of return, and its financial integrity would be substantially compromised." Verizon's Motion to Reopen, at 2. The gist of Verizon's argument is that assuming 2002 retail rates and current UNE rates, it purportedly will not be able to recover all of its historic investment.

As noted above, this analysis is fatally flawed for a number of reasons, including Verizon's failure to account for the recently approved increases in its basic residential rates, or its new grant of upward pricing flexibility for a wide array of retail business services. More fundamentally, however, this motion must be denied because the merits of Verizon's claim cannot properly be addressed here. This does not mean that Verizon has no remedy, and Verizon knows perfectly well what it is. Verizon can ask the Department to initiate a full-blown investigation into Verizon's rate of return..

This is the only way in which the Department could meaningfully evaluate the claims that Verizon has asserted in its motion to reopen this proceeding. A rate case would be a substantial burden for the Department and its staff, let alone the other interested parties, at a time when – in addition to all of its other responsibilities – the Department is obligated to mount a substantial investigation of whether Verizon can meet its burden of overcoming the national finding by the FCC that CLECs would be impaired from entering the local exchange mass market without access to unbundled switching and UNE-P. Yet, for the reasons specified here, it is obvious that

Verizon's current filing – which is not a serious takings claim – does not come close to justifying the Department's devotion of its time and energies to such a proceeding.

Accordingly, the Department should reject the motion. As Verizon knows full well, Verizon is free to file a petition, with appropriate evidentiary support, for an investigation into the adequacy of all of its rates in allowing it to each an appropriate return on its investment. That is the proper approach for Verizon to pursue a complaint that its overall rate of return is too low, and nothing prevents Verizon from pursuing it.

III. THE DEPARTMENT SHOULD STRIKE THE ADDITIONAL EVIDENCE SUBMITTED BY VERIZON WITHOUT AUTHORIZATION, AS WELL AS ALL REFERENCES TO IT IN VERIZON'S MOTION.

It was improper for Verizon to have submitted its proposed evidence, consisting of written but unsworn testimony and four alternative "cost studies." AT&T hereby moves that this evidence, and all of Verizon's references to it, be stricken.

Verizon is well aware of the requirement that a party may not submit additional evidence after a proceeding has been concluded unless and until its motion to reopen the proceeding has been granted. *See, e.g., Petitions of MediaOne Telecommunications and New England Telephone for Arbitration*, D.T.E. 99-42/43, 99-52 (1999), at fn. 14 (granting motion to strike late-filed evidence from Verizon); *Petition of New England Telephone for an Alternative Regulatory Plan*, D.P.U. 94-50 at 59 (1995). As the Department has explained:

> [I]n seeking to reopen the evidentiary record, the proper procedure is for the moving party to submit a motion which states the subject or issue that the proffered exhibit or testimony would address. Boston Gas Company, D.P.U. 88-67, Phase 1, at 7 (1988). Only if the motion is granted, is it then proper to present the exhibit or testimony itself. The Department's rationale for this rule is that the presentation of extra-record evidence to the fact finder after the record has closed is potentially prejudicial to the rights of other parties even when the evidence is ultimately excluded (id.).

Blackstone Gas Co., D.T.E. 01-50 at 15-16 (2001).

The circumstances of this case epitomize the Department's concern that unfair prejudice can result from the unauthorized presentation of extra-record evidence. Verizon is currently prosecuting a no-holds-barred, nationwide attack on its legal obligation to provide just, reasonable, and nondiscriminatory wholesale access to its local exchange network. Despite the fact that this network was built and maintained for the public convenience and necessity, Verizon insists that it should now be able to put this network to its own monopolistic purposes and to prevent competitors from using it on an economically viable basis. A major part of Verizon's rhetorical excess is to repeat *ad naseum* the unsupported and unsupportable claim that compliance with the TELRIC methodology necessarily results in "below cost" UNE rates. It appears that Verizon chose to submit additional factual claims in this proceeding, in knowing violation of the Department's procedural rules against doing so, because it believes that having this untested and self-serving "evidence" in the record of this proceeding will advance its nationwide campaign against UNEs and against TELRIC. For the reasons discussed above, the testimony and models proffered here by Verizon are fatally flawed and do not prove that Verizon cannot recover its historical investments and ongoing expenses with the newly approved Massachusetts UNE rates in place. But demonstration that Verizon's unauthorized evidentiary offering is not credible is insufficient to remedy the prejudice created by its improper submission.

As the Department has previously held, the proper remedy is to strike the new evidence proffered by Verizon, and to strike all references to that evidence contained in Verizon's motion to reopen. *See Blackstone Gas Co.*, D.T.E. 01-50 at 15 (2001); *Petition of New England Telephone for an Alternative Regulatory Plan*, D.P.U. 94-50 at 64 (1995).

Conclusion

For the reasons stated above, AT&T respectfully urges the Department: (i) to deny Verizon's motion to reopen the record; and (ii) to strike Verizon's proposed evidence, and all of Verizon's references to it. If however, the Department were to grant Verizon's motion to reopen this docket, AT&T respectfully requests that the Department then schedule a procedural conference to address how the Department would undertake a full-blown rate-of-return investigation in order to investigate the "total effect" and "end result" of all of Verizon's costs, rates, and revenues.

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